CalPERS Pension Costs Update

Follow Up Workshop on UAL Restructuring Options

The Bayshore Consulting Group, Inc.

City of Rialto, California — Incorporated Nov. 17, 1911 — "Bridge to Progress"

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May 11, 2021

Background & Presentation Focus

- City projects a $132M CalPERS Unfunded Accrued Liability (UAL) for 6/30/2021
  - 144% increase (from $54M) over last 9 years
  - Annual UAL payments have grown from $5.3M (2015) to $9.7M (2020)
    - Projected to grow to $15.2M by 2030
  - City has explored various cost management strategies over the past several months through multiple council and committee meetings
  - UAL restructuring concept being evaluated given historically low interest rates (3.00% to 3.50%) vs. the 7.00% rate being paid on CalPERS UAL debt
    - Restructuring also promotes potential City objective to "re-shape" and smooth its payments for more predictable budgeting to ensure that service levels are maintained, to bolster reserves, and to enhance "resiliency" against future economic shocks or CalPERS underperformance
- Two types of UAL restructuring financing methods are available
  - Pension Obligation Bonds (POBs) and Lease Revenue Bonds (LRBs)

POB vs. LRB: Overview Comparison

POB

(most utilized method for UAL Restructure)

- Validation Required to confirm UAL as existing "debt" that can be refinanced
- Pros – Unsecured / No asset required, same rating as Issuer Credit Rating (1-notch higher than LRB); lower interest rate than LRB (likely 0.15% to 0.35% lower)
- Con – 4 to 5 month timeframe; potential legal challenges; limited direct placement investors; low chance of bond insurance

Lease Revenue

(less used, but increased activity recently)

- Recent Assets utilized (buildings, streets, parks; utility assets not advisable)
- Pro – no validation process required so about 2 months quicker process than POB; <u>potentially</u> more flexibility with use of proceeds (timing of deposits to CalPERS/115 Trust and options for upfront reimbursement)
- Con – using up asset capacity, 1 notch lower rating; 0.15% to 0.35% higher interest rate

POBs vs. LRBs: Hypothetical Schedule Comparison

- POB Timeline
  - Assume City Council confirms direction to proceed with POB
    - Validation Commences by May 18th
  - June: Bond structuring discussions
  - July: Begin credit and disclosure diligence and documentation
  - August/September: finalize credit and disclosure documentation, secure credit rating, City Council approves remaining documents to proceed to bond sale, receive court judgement
  - September/October: 30 day protest period from date of judgement ends, bond sale and closing, transfer funds to CalPERS

- LRB Timeline
  - Assume May 11th City Council direction to proceed with LRB
  - May/June: Bond structuring discussions, begin and finalize credit and disclosure diligence and documentation, secure credit rating
  - June/July or August: City Council approves documents to proceed to bond sale, bond sale and closing, transfer funds to CalPERS

POBs vs. LRBs: Hypothetical Savings Comparison

- POB Assumptions
  - Credit Rating: AA-
  - Bond Size: $110,000,000
  - Maturity: FY 2042/43
  - All-In Interest Rate: 3.20%
- POB Savings
  - Present Value $s/%: $37.2M / 33.8%
  - Total: $39.4M
  - Through 2033: $51.2M
  - Average Annual (2023-2033): $4.65M

- LRB Assumptions
  - Credit Rating: A+
  - Bond Size: $110,000,000
  - Maturity: FY 2042/43
  - All-In Interest Rate: 3.44%
  - Security: City Streets (~$400M Value); no bond holder right to foreclose, preserve City right for use of this asset for additional bonds
- LRB Savings
  - Present Value $s/%: $34.8M / 31.6%
  - Total: $36.6M
  - Through 2033: $49.7M
  - Average Annual (2023-2033): $4.51M

LRB = $140K higher annual payment vs. POB

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Savings Sensitivity to Interest Rates

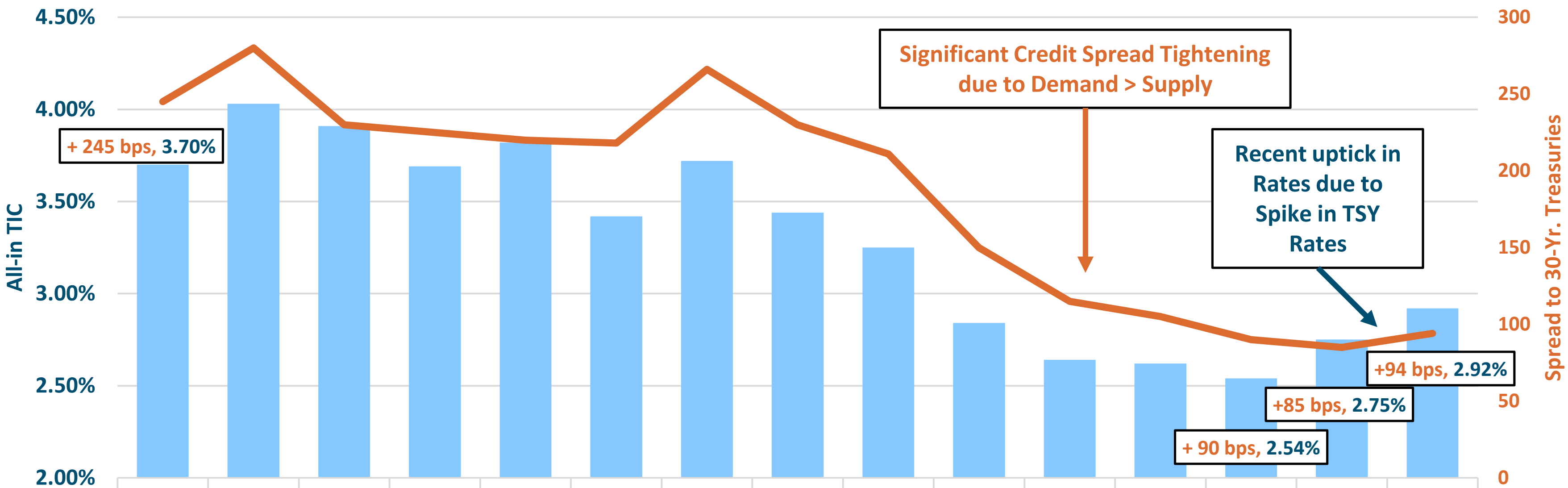
- Given POBs would take 2 months longer to come to market, useful to examine recent trends and volatility, as well as sensitivity of transaction to interest rates
  - "Apples to apples" comparison as shown on previous page results in an estimated .21% (vs. .24% rate differential) break-even due to lower LRB rating and structure, but also accounting for benefit of sending CalPERS payoff monies 2 months sooner
    - Difference between POB and LRB is between .15% and .35%, depending upon market conditions
  - Since pandemic started, market has exhibited positive (downward) trends
    - "Flight to Quality" has pushed TSY yields down through February 2021; recently, inflation concerns with positive economic news and governmental stimulus has creates some uptick in TSY yields with moderate volatility
    - As investor's have reviewed more of these CA UAL restructurings (either POBs or LRBs) and have gained better understanding of goals and benefits being derived by the public agencies utilizing them, these investors have accepted increasingly lower "spreads" to the TSY benchmarks; thus, absolute POB and LRB interest rates have generally come down
  - Interest rates between a POB and LRB for the City may change depending upon overall market volatility, supply and demand for such bonds, individual investor preferences/needs at the time of a bond sale, outlook on future interest rates and other factors

Market Update
Taxable Interest Rate Trends (30-Year Treasury Rates)

*Interest rates through April 16, 2021.

POB Market Update - Rates Have Dropped Over 1.00% in Last Year

But, Slightly Rising Trend over last 3 Months



Ontario	May 2020	$237M	AA/AA-	POB
Montebello	May 2020	$150M	A+ (AA Ins.)	POB
Inglewood	June 2020	$102M	AA- (AA Ins.)	POB
Riverside (City)	June 2020	$430M	AA	POB
El Monte	June 2020	$118M	A+ (AA Ins.)	POB
Carson	June 2020	$108M	AA-	POB
West Covina	July 2020	$200M	A+	Lease
Torrance	Oct. 2020	$350M	AA	Lease
Gardena	Nov. 2020	$101M	AA-	POB
El Cajon	Jan. 2021	$147M	AA	POB
Monterey Park	Feb. 2021	$106M	AA	POB
Downey	Feb. 2021	$114M	AA	POB
Chula Vista	Feb. 2021	$350M	AA (AA Ins.)	POB
Orange	Mar. 2021	$286M	AA (AA Ins.)	POB
Hungtington Beach	Mar. 2021	$364M	AA+	POB

Summary and Next Steps

- The bond market remains at historically low absolute interest rate levels
- The City Council has given direction to proceed with validation for a POB; however, if a LRB is preferred path to restructuring the City's UAL, then it is best—from a cost and processing viewpoint—to not file the initial validation with the court
- The Choice between POB or LRB largely falls on one's view of:
  - Future interest rates
  - Concerns about potential future legal challenges to a POB validation
  - Does LRB transaction provide enough savings and restructuring benefit now?
  - Market timing of investing funds with CalPERS at beginning of FY (i.e. July) vs. later
    - A significant downturn in CalPERS returns could warrant waiting to close financing—assuming interest rates remain stable—to mitigate a first-year negative impact from the bond issuance
- If the City Council confirms that the POB is preferred bond structure, then bond counsel will file the necessary paperwork with the court within 3-5 business days
- Or, iF City Council now determines that the LRB is the preferred bond structure, direction should be given to staff and the financing team to proceed expeditiously to bring back legal and disclosure documentation for its review